89-1349

No.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

110-118 RIVERSIDE TENANTS CORPORATION,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Does the decision of the court below which awards the Government, pursuant to a tax lien, more of the proceeds of an involuntary sale of the taxpayer's property than the taxpayer was entitled to under state law conflict with controlling decisions of this Court which hold that the Government's lien cannot extend beyond the property interests held by the taxpayer?

2. Does the decision of the court below which treats contract rights as if they were security interests when they are not so treated under state law conflict with this Court's decision in United States v. Durham Lumber Co.?

3. Does the decision of the court below which holds that the taxpayer's interest in a contract must be valued at the time a tax lien is filed regardless of his subsequent default under the contract conflict with the decision of the Seventh Circuit in Chicago Mercantile Exchange v. United States which holds that the interest must be valued at the time specified in the contract regardless of when the lien is filed?

4. Does the award by the court below to the Government, pursuant to a tax lien, of the entire proceeds of the sale of property in which the taxpayer, pursuant to contract, has only a partial interest, constitute a gratuitous confiscation of the property of the party entitled to the balance of such proceeds, in violation of the Fifth Amendment?

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1989

110-118 RIVERSIDE TENANTS CORPORATION,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE PETITIONER

The petitioner 110-118 Riverside Tenants Corporation respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on September 28, 1989.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit is reported at 886 F.2d 514 (2d Cir. 1989), and is reprinted in the appendix hereto, p. A-1, infra. The Opinion of the United States District Court for the Southern District of New York (Cannella, D.J.) has not been reported. It is reprinted in the appendix hereto; p. A-34, infra.

JURISDICTION

The judgment of the United States Court of Appeals for the Second Circuit was entered on September 28, 1989.

The petition for rehearing with suggestion for rehearing en banc was denied on November 21, 1989. (p. A-32, infra.).

This Honorable Court has jurisdiction to review the judgment of the Court of Appeals by writ of Certiorari pursuant to 28 U.S.C. Section 1254(1).

The jurisdiction of the District Court was based on Sections 7402 and 7403 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. §7402 and §7403, and 28 U.S.C. §1340 and 1345.

STATUTES INVOLVED

26 U.S.C. §6321. Lien for taxes.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

United States Constitution, Amendment V

No person shall be . . . deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use without just compensation.

STATEMENT OF THE CASE

A. The Tax Liens

On December 1, 1968, John G. Broady acquired a cooperative apartment ("Apartment") at 110 Riverside Drive, New York City, by purchasing stock in the 110-118 Riverside Tenants Corporation ("Apartment Corporation")[1] and entering into a proprietary lease for the Apartment.

In 1975 the Internal Revenue Service filed notices of tax liens against Broady, under 26 U.S.C. §6321. In 1979 the Government commenced an action in the district court against Broady.[2] In 1984 the Government was awarded judgment for $2,396,264.12, and on March 11, 1985, a judgment of foreclosure on Broady's shares of stock in the Corporation was entered.

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1. Petitioner 110-118 Riverside Tenants Corporation has no affiliates or subsidiaries.

2. Although the Apartment Corporation was made a defendant, the complaint asserted no claims against it. (App. 6-11).

It was not until April 1985, after the judgment of foreclosure, that Broady first defaulted on his maintenance payments due to the Apartment Corporation.

B. The Sale of the Apartment

At no time after the foreclosure did the Government take any action to evict Broady, or take any action to sell the Apartment, or to carry out its foreclosure.

In October 1985, the Apartment Corporation terminated Broady's proprietary lease (App. 68, 75)[3] and voided his shares by reason of his continued non-payment of maintenance, and in 1986 evicted Broady by means of an action in the Civil Court, New York County. In July 1987 the Apartment Corporation entered into a contract for

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3. The notation App. followed by a page number refers to a page in the Joint Appendix submitted to the Circuit Court.

the private sale of the Apartment, for the sum of $901,030.

In September 1987 the Apartment Corporation moved in the District Court for an order approving its private sale of the Apartment "after payment of monthly arrearages owed by defendant Broady to the cooperative corporation".

In January 1988 a stipulation was entered into regarding the sale of the Apartment, pursuant to which the Government published a public notice of the sale, and solicited higher bids. None were received, and the sale was confirmed by the District Court (App. 124-125).

In April 1988 the closing took place. Under the stipulation, more than $810,000 was paid to the Government, and the balance of $90,103, to which the Apartment Corporation was entitled under the terms of the lease for unpaid

maintenance charges, legal fees, real property transfer tax, and other miscellaneous charges, was retained in escrow by counsel for the Apartment Corporation, pending the disposition of this case.

C. The Proprietary Lease

The right of a cooperative to retain its unpaid maintenance and other charges out of the proceeds of the sale of the apartment is established by a proprietary lease.

In general, the purchaser of a cooperative apartment receives a "package of rights"[4] constituting a proprietary lease for the premises and a number of shares of the cooperative corporation which are allocated to the apartment. The proprietary lease requires that the tenant-shareholder pay

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4. 886 F.2d. at 516; accord, Malkin v. Dept. of Treasury, 645 F.Supp. 229, 231 (S.D.N.Y. 1986).

monthly rent, called "maintenance", the amount being determined by the number of shares allocated to the apartment (App. 89-90).

The proprietary lease in this case provides that the Cooperative must approve the voluntary transfer of the shares and the assignment of the lease. The lease and shares can not be transferred, either voluntarily or involuntarily, without payment of all sums due to the cooperative (App. 93-94).

In the event of default, the lease provides that it may be terminated by the Apartment Corporation on ten days' notice. The Apartment Corporation may then sell the apartment at a private or public sale, applying the proceeds to the indebtedness of the lessee under the lease, and expenses of the sale. The cooperative is only obligated to pay

over any surplus to the lessee (App. 90-91, 108).[5]

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5. The full clause is as follows:

> Fourth: Upon the termination of this lease ... the Lessee shall surrender to the Lessor his certificate or certificates for the shares of the Lessor owned by the Lessee. Whether or not said certificates or certificates are surrendered they shall be deemed void and the Lessor may sell such shares at public or private sale and may issue a new proprietary lease for the apartment and issue a new certificate for the shares of the Lessor formerly owned by the Lessee and allocated hereunder. The Lessor may apply the proceeds received for the issuance of such shares towards the payment of the Lessee's indebtedness hereunder, including interest, attorneys' fees and other expenses incurred by the Lessor and if the proceeds are sufficient to pay the same, the Lessor shall pay over any surplus to the Lessee, but if such proceeds are insufficient the Lessee shall remain liable for the balance of indebtedness.
>
> Upon the issuance of any such new proprietary lease and certificate, the Lessee's continuing liability hereunder shall cease and the Lessee shall only be liable for rent and other obligations under this lease accrued to that time.

D. The Decisions Below

Both the District Court and the Court of Appeals held that the lien of the Government took priority over the contractual rights of the cooperative pursuant to the proprietary lease, albeit on substantially different grounds.

The Court of Appeals held that the shares of stock and the proprietary lease representing a cooperative apartment "are inseparable and must be treated as a unit".[6] However, the Court stated that if the claim of the Apartment Corporation pursuant to the lease is considered "as a secured interest in the nature of a lien"[7], it was "inchoate"[8] when the Government

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6. 886 F.2d at 518.

7. Ibid.

8. Ibid.

filed its lien.

The Court reviewed the language of the lease, and concluded that the taxpayer was entitled to all of the proceeds of a sale at the time the lien was filed because there was then no default and no sum due to the cooperative, and it had no right at that time to sell the shares nor any right to the proceeds.

The Court's analysis stops at this point - it never answers the question of whether under state law the claim of the Apartment Corporation was "a secured interest in the nature of a lien", nor did it determine any other basis for measuring the contract rights of the cooperative at the time the lien was filed, rather than at the time the contract required for the liquidation of the lessee's obligations.

E. The Proprietary Lease is not Unique

The court below stated that the property rights of an owner of a cooperative apartment are "unique".[9] The fact is that the terms of the lease that are relevant to the decision of this case are not unique at all.

The proprietary lease in this case provides two limitations on the right of the lessee to obtain the entire proceeds of a sale of an apartment upon a transfer, that are relevant here.

In order to voluntarily transfer the apartment, the lessee must pay all sums due to the cooperative.(App. 94) Upon an involuntary transfer, the lessee may be divested of both title to and possession of the apartment, and is entitled only to the net amount of the

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9. 886 F.2d at 516.

proceeds of an involuntary sale, after payment of all charges due to the cooperative.(App. 108)

Neither of these restrictions on the rights of a lessee are unique, in any sense. These types of restrictions are common not only to many proprietary leases, but to many other types of contractual arrangements that contain identical or similar restrictions.

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals is in conflict with controlling precedent, and is in conflict with the Constitution, and should be reviewed by this Court.

I. THE DECISION OF THE COURT OF APPEALS FOR THE SECOND CIRCUIT IS IN DIRECT CONFLICT WITH PRIOR CONTROLLING DECISIONS OF THIS COURT.

The decision of the Second Circuit conflicts on three separate substantial issues with the decisions of this Court.

1.

The principle on which the decision below is based is that the filing of a tax lien under 26 U.S.C. §6321 on a taxpayer's contract rights has a material effect on the determination of the value of those rights under the contract.

The court below held that in order

to determine the amount the Government is entitled to pursuant to the tax lien, the lease rights of a proprietary lessee should be valued as of the date of the filing of the tax lien on the lessee, rather than as of the date that the contract requires for the determination of lessee's contractual obligations.

The court below applied the doctrine of "choateness" to the enforcement of the cooperative's contract rights, and held that the rights of the Government, valued when the lien was filed, rose higher than those of the taxpayer, valued at the completion of performance under the contract, because rights arising out of the taxpayer's default occurring after the filing of a tax lien may not be enforced against the Government.

This aspect of the decision of the

Court of Appeals is in direct conflict with the controlling cases of United States v. Bess, 357 U.S. 51, 78 S. Ct. 1054 (1958), Aquilino v. United States, 363 U.S. 509, 80 S. Ct. 1277 (1960); and United States v. Durham Lumber Co., 363 U.S. 522, 80 S. Ct. 1282 (1960).

In United States v. Bess, 357 U.S. 51, 78 S. Ct. 1054 (1958), this court held that the tax lien statute "creates no property rights but merely attaches consequences federally defined to rights created under state law", and that "the rights of the insured are measured by the policy contract, as enforced by [state] law." 357 U.S. at 55, 78 S. Ct. at 1057.

In Aquilino, this court held that the "threshold question" is "whether and to what extent the taxpayer had 'property' or 'rights to property' to which the tax lien could attach." 363

U.S. at 512, 80 Sup. Ct. at 1280. This court ruled that the answer is found in state law.

Once the state created property interests have been identified, federal law determines only the priority of competing liens. This court rejected the argument that the time of filing the tax lien was material to the enforcement of the state created rights under the contract.

In Durham Lumber the Government contended, as it did below, that all the money owing under the contract was property of the taxpayer, to which the tax lien attached. This court found that under state law the contractor was only entitled to receive the residue of payment under the contract after all subcontractors have been paid. The general contractor did not have a property interest "in the face amount" of the construction contract.

The fundamental basis for Bess, Aquilino, and Durham, is that the filing of a tax lien does not create rights, or alter state created contractual rights. This was reaffirmed in United States v. Rodgers, 461 U.S. 677, 691, 103 S. Ct. 2132, 2141 (1983). The government may only "ultimately" collect what the taxpayer is entitled to.

In contrast, the Second Circuit took the position that the filing of the tax lien froze the financial obligations under the contract as against the Government, and that the Government could take what the taxpayer would hve been entitled to if the contract had been liquidated at that time, regardless of the fact that the contract did not require liquidation at that time, and regardless of subsequent defaults by the taxpayer.

In short, the Second Circuit deliberately awarded the Government more

than the taxpayer was ultimately entitled to under the contract. The decision of the Second Circuit disregards the principles of federalism that require state law to determine the property rights of the taxpayer, and federal law to determine only the extent to which a tax lien transfers the state created rights to the Government.

2.

Second, the Second Circuit's decision that the property rights of the cooperative under a proprietary lease are to be treated as a "secured interest in the nature of a lien"[10] directly conflicts with the Durham decision that a contract right is not to be so treated unless it is so treated under state law.

In Durham, this court expressly rejected the argument that the

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10. 886 F.2d at 518.

subcontractor's interest should be treated as "equivalent to a lien" when it is not so treated under state law. 363 U.S. at 526 n.4, 80 S.Ct. at 1284.

The Second Circuit's decision did not analyze whether New York law treats the contract rights of a cooperative as a "secured interest in the nature of a lien".

The fact is that New York law does not so treat rights under a proprietary lease. This conclusion is a necessary corollary of the holding of Part I of the Second Circuit's decision, that the shares of stock and the proprietary lease are "inseparable and must be treated as a unit"[11], citing the

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11. 886 F.2d. at 518.

leading state[12] and federal[13] cases on this issue.

More directly, the Appellate Division, First Department, expressly held in Banks v. Cox, Treanor & Shaughnessy, 81 A.D.2d 504, 437 N.Y.S.2d 331 (1st Dept. 1981), that a claim for rent and expenses out of the proceeds of a sale of an apartment does not constitute a lien[14].

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12. State Tax Commission v. Shor, 43 N.Y. 2d 151, 400 N.Y.S.2d 805, 371 N.E.2d 523 (1977); Fe Bland v. Two Trees Management Co., 66 N.Y.2d 556, 563, 498 N.Y.S.2d 336, 340, 489 N.E. 2d 223 (1985).

13. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 842, 95 S.Ct. 2051, 2055 (1975); Genader v. Spitz, 537 F.2d 612, 615, 617 (2d Cir. 1976), cert. denied, 429 U.S. 1009, 97 S.Ct. 541 (1976); Malkin v. Department of Treasury, 645 F.Supp. 229, 231 (S.D.N.Y. 1986).

14. The suit charged the cooperative with asserting a "false and exaggerated lien", by demanding payment for rent and expenses. The court held that "It is plain that no lien was asserted". 437 N.Y.S.2d at 333.

Since state law does not treat the cooperative's interest as a lien, the Second Circuit decision is in conflict with the principle of federalism embodied in Durham.

3.

The Second Circuit stated that "a seat on an exchange [is] ... encumbered with conditions not applicable to shares in a cooperative"[15], as a basis for distinguishing Chicago Mercantile Exchange v. United States, 840 F.2d. 1352 (7th Cir. 1988).

In order to sustain this asserted distinction, it is necessary to hold that principles of tax lien law relevant to one kind of contract should not be be applied to other contractual arrangements, because of the different nature of such contracts.

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15. 886 F.2d at 519.

This asserted distinction is further in direct conflict with the decision of this Court in Aquilino, where this Court expressly rejected the notion that "unique circumstances" with respect to insurance contracts limited the application of United States v. Bess.

This Court expressly held there is no distinction between an insurance contract and a construction contract with respect to the general principle which governs all of these cases, namely that the government can take no more than the contract rights of the defaulting taxpayer enforceable under state law, regardless of when the tax lien is filed. 363 U.S. at 513 n.4, 88 S. Ct. at 1280.

This basic principle has subsequently been applied not only to stock exchange rules (See Point II, infra.), but to construction contracts, bank set-offs,

land sale contracts, and liquor licenses. (See Point III, infra.). In some senses, each of these kinds of contract is unique.

Indeed, there are much greater distinctions between an insurance contract and an exchange membership, than between exchange membership and a proprietary lease. The Seventh Circuit held that United States v. Bess applied to the Chicago Mercantile Exchange. To achieve uniformity of enforcement of the tax laws, it should apply here as well.

4.

The Second Circuit's decision is consistent only with the dissenting opinion of Justice Harlan in the Aquilino and Durham Lumber cases, 363 U.S. 516, 80 S. Ct. 1285. Justice Harlan pointed out that the interests ofthe subcontractors that were entitled to priority were not considered "choate"

under the applicable decisions. 363 U.S. at 517, 80 S. Ct. at 1286. Justice Harlan asserted, in substance, that since the rights of the subcontractors were state-created, a federal tax lien filed prior in time to the claims of the subcontractors was entitled to priority. This position was rejected by this Court.

II. THE DECISION BELOW DIRECTLY CONFLICTS WITH A DECISION OF THE SEVENTH CIRCUIT.

In Chicago Mercantile Exchange v. United States, 840 F.2d 1352 (7th Cir. 1988), the Seventh Circuit held that stock exchange rules - which limit a defaulting member to recovery of the net value of his seat after payment of specified claims - took priority over a tax lien even though the lien was filed before the member defaulted in his obligations to the exchange.

The Seventh Circuit rejected the argument that the rules constituted an "unperfected security interest"[16] in the seat, and held that the rules were an incident of the membership from the outset, and constituted a limitation on the property interests of the member.

The decision below is in direct conflict. The court below sought to distinguish Chicago Mercantile Exchange on the ground that a cooperative shareholder is entitled to the full value of the shares, unless he is in default.[17] The court implied, without so stating, that an exchange member could never receive the full value of

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16. 840 F.2d. at 1355.

17. The court also asserted the cryptic ground that a seat on an exchange is encumbered with conditions not applicable to shares in a cooperative. This issue is covered in Point I (3), supra.

his seat.[18] The significance of this asserted distinction between the rights of the exchange member and the proprietary lessee is not explained by the court below. In fact it has no relevance at all.

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18. In fact there is substantially no difference at all between the rights of an exchange member and a proprietary lessee. The provisions for transfer of a seat on the stock exchange are substantially identical to the provisions for transferring a proprietary lease. Compare 840 F.2d at 1354 with 886 F.2d at 519, and App. 93-94. Both voluntary and involuntary transfer of exchange membership are governed by the rules of the exchange, as are voluntary and involuntary transfer of a cooperative apartment governed by the terms of the proprietary lease.

    With respect to voluntary transfer, exchange rules require approval of the transfer, and payment of certain obligations as a condition of transfer. Similarly, as set forth above, the proprietary lease provides that the lease and shares may not be transferred voluntarily without the consent of the corporation and payment of all fees owed at the time of transfer.

    With respect to involuntary

There is no distinction between the facts before the Seventh Circuit and the facts before the Second Circuit with respect to the timing of the filing of the tax lien. In both cases the lien was filed at a time when the taxpayer was not in default of his contractual obligations.

The fact is that the Seventh Circuit found that the time of filing the tax lien was not material to a determination of the rights of the exchange - which

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(footnote 18 continued)

transfer, the proprietary lessee is divested of title and possession, and is relegated to the net proceeds of the sale of the Apartment after payment of the cooperative's expenses. Exchange rules require payment of certain obligations to the exchange and its members. The rules provide that after payment of these obligations "the surplus, if any, shall be paid to the person whose membership was sold". 840 F.2d at 1354 n. 2. A comparison of this language with the language of the proprietary lease shows that the terms are virtually identical. See, 886 F.2d. at 519.

were determined as of the time the member's interest was liquidated. The Second Circuit found that the time of filing the lien was material, and that the cooperative's rights were to be determined as of the time the lien was filed, even though the lessee's interest was not liquidated until 12 years later.

Even if the Second Circuit were correct in stating that the exchange member had lesser property rights in his seat at the time the lien was filed, then did the proprietary lessee of the cooperative, the distinction is not material to resolving the conflict between the circuits.

The material issue is not the extent of the proprietary lessee's rights under state law. The issue is whether the filing of a tax lien could affect the extent of those rights, whatever they may be.

It is evident that the decision below is in material conflict on a significant issue of the extent of the rights conferred by 26 U.S.C. §6321. This court should resolve this conflict.

III. THE DECISION OF THE COURT OF APPEALS FOR THE SECOND CIRCUIT IS IN CONFLICT WITH DECISIONS OF THE EIGHTH, NINTH, AND THIRD CIRCUITS.

The holding of the Second Circuit that a tax lien upon the rights of a party to a contract, divests the other party to the contract of its right to set off a subsequent breach by the taxpayer of its obligations under the contract, is in direct conflict with decisions of several of the other Circuits.

In Johnson v. United States, 799 F.2d 374 (8th Cir. 1986); Brookbank, Inc. v. Hubbard, 712 F.2d 399 (9th Cir. 1983); and Runkel v. United States, 527 F.2d 914 (9th Cir. 1975), the Government

filed a tax lien upon a purchaser's rights under a real estate sale contract, at a time when the purchaser was not in default. The purchaser's subsequent default in each case entitled the seller to enforce its contractual rights to terminate the contract, and the purchaser's right to possession. In each case the purchaser forfeited all its rights under the contract, to the detriment of the Government[19].

The same principle has been applied to an automatic right of setoff allowed to a bank under state law in Pittsburgh National Bank v. United States, 657 F.2d 36 (3d Cir. 1981). The tax liens in that case were filed in 1975. The taxpayer did not default on its note to the bank until 1977. Nonetheless, the

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19. See also United States v. Maniscalco, 523 F. Supp. 1338 (U.S.D.C. E.D. La. 1981).

taxpayer's interest in his checking account was extinguished by the bank's right of setoff under state law, and the bank was not obligated to turn over any of the account to the Government.

In each of these cases, the property rights of the taxpayer were limited or completely divested by reason of a default occurring after the imposition of the tax lien, and the Government's right were thereby equally limited.

The result of the decision below is that the enforcement of Section 6321 is different in different sections of the country. We submit that collection of taxes is an area that requires complete uniformity among the circuits.

IV. THE DECISION OF THE COURT BELOW SANCTIONS A GRATUITOUS CONFISCATION OF THE PROPERTY INTERESTS OF THE COOPERATIVE

The Second Circuit discreetly did not expressly acknowledge in its decision that if the tax lien had not intervened, and the dispute here were directly between the defaulting lessee and the Apartment Corporation, there is simply no question that the Apartment Corporation would be entitled to the sums in dispute, and would only be obligated to the proprietary lessee for the net proceeds of the sale of his apartment.

In Banks v. Cox, Treanor & Shaughnessy, 81 A.D.2d 504, 437 N.Y.S.2d 331 (1st Dept. 1981), the Appellate Division, First Department, specifically held that a cooperative was entitled to payment of its unpaid maintenance, together with all other costs and

expenses of selling the apartment, from the proceeds of a sale.

This Court has expressly stated that "the government may not ultimately collect, as satisfaction for the indebtedness owed to it, more than the value of the property interests that are actually liable for that debt". United States v. Rodgers, 461 U.S 677, 691, 103 S. Ct. 2132, 2141. (Emphasis added.) The value of the lessee's interest at the time the Apartment was sold was only the net amount, after deduction of the charges due the Apartment Corporation.[20]

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20. The possibility that had the apartment been sold when the taxpayer was not in default, the Government would have been entitled to the entire proceeds of the sale is utterly irrelevant, because the lease did not require an involuntary sale at that time, and the fact is that neither the Government nor the taxpayer voluntarily sold the apartment at that time.

In the face of this Court's fixed rule that a tax lien "creates no property rights",[21] the refusal to allow the Apartment Corporation to retain the sums due it under the proprietary lease by reason of the taxpayer's default, and to require it to pay that sum to the Government, patently amounts to a "gratuitous confiscation of one person's property interests in order to satisfy another person's tax indebtedness", 461 U.S. at 697, 103 S. Ct. at 2144, and as such poses "significant difficulties under the Due Process Clause of the

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21. United States v. Bess, 357 U.S. at 55, 78 S.Ct. at 1057. Accord, United States v. National Bank of Commerce, 472 U.S. 713, 105 S. Ct. 2919 (1985).

Fifth Amendment".[22]

It is respectfully submitted the decision of the court below has gratuitously confiscated the Apartment Corporation's rights pursuant to its proprietary lease, and taken the sums due it under the lease and paid them to the Government instead.[23]

This court should not permit such an egregious result.

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22. Accord, United States v. Chicago Mercantile Exchange, supra, 840 F.2d. at 1356. See also Hoeper v. Tax Commission of Wisconsin, 284 U.S. 206, 52 S. Ct. 120 (1931).

23. If the Circuit Court's decision is correct, then from and after the date of its tax lien, the Government could have levied on each of the taxpayer's maintenance payments as they came due, and placed them in the coffers of the Government, rather than allowing them to be paid to the Apartment Corporation, and the Apartment Corporation would not be entitled to recover such payments from the Government.

V. THIS COURT SHOULD REVIEW THE INSTANT CASE BECAUSE IT CONCERNS A MATTER OF SUBSTANTIAL PUBLIC IMPORTANCE

1.

The issue presented in the instant case - the conflict between state-created contract rights and a federal tax lien - recurs with frequency in the federal courts.[24]

This case involves the effect of a tax lien upon the contractual right to terminate and liquidate the property rights of one of the parties. This court has not previously addressed this question, and there is now a conflict in the decisions of the courts below. Review by this Court will establish a uniform rule with respect to this issue.

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24. See, e.g., Liens Competing With Federal Tax Priorities, 94 A.L.R.2d 748 (1963), and supplements thereto.

The decision below will cause an uneven application of the tax laws, and will cause persons in different judicial circuits to pay different taxes on the same or similar transactions.

Review by this Court will serve important national policies because of the necessity of uniformity of the collection of taxes. As the law now stands, more taxes will be paid in the Second Circuit than in the Seventh Circuit in similar circumstances.

2.

The conflict created by the Second Circuit decision creates substantial problems for housing cooperatives. We are advised that there are well over one hundred thousand cooperative properties in the United States, and as many as one million individual cooperative apartments or units. We understand that there are over five thousand cooperative projects having over 500,000 individual

units in the New York City area. Many homeowners have an interest in the outcome of this case.

The decision of the Court below can cause particular damaging consequences. Cooperatives are typically operated on a break-even basis - the proprietary lessees bear the operating costs on a pro-rata basis.

If a cooperative is disabled from collecting maintenance arrears from one of its lessees, by reason of an intervening tax lien, the other lessees will have to bear the burden, and their maintenance charges will be proportionately increased. In effect, the other shareholders will proportionately pay the defaulter's taxes.

As soon as a tax is lien filed upon a lessee, the cooperative may be forced to evict him even if he is not then

financially in default to the cooperative, because of the potential consequences of this decision.

The problem is particularly significant in New York at this point because of the recent defaults of many sponsors holding large blocks of apartments in partially converted cooperatives.[25] Sponsors may continue to hold from ten to eighty percent of the shares of a cooperative, as a result of New York's "non-eviction" conversion process.[26]

As a result of recent weaknesses over the past two years in the resale market for all residential real estate in the Northeast area, including cooperatives, a substantial number of

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25. See, The New York Times, January 21, 1990, Section 10, p. 7, col. 1; February 4, 1990, Section 10, p. 1, col. 2.; Crain's New York Business, January 22, 1990, p.3, col. 4.

26. New York Times, January 21, 1990, Section 10, p. 1, col. 2.

sponsors, about 90, each holding large blocks of "unsold" apartments occupied by rent regulated tenants in one or more cooperatives, have gone into default on their obligations to the cooperatives.[27] At least one substantial sponsor, holding interests in many buildings, has indicated that he is financially shaky.[28]

Accordingly, there is a serious threat of widespread default by apartment owners in the New York area at the present time, with the potential for jeopardizing the financial security of many buildings. Resolution of the conflict between the Second and Seventh Circuits with respect to priority of rights of the cooperative upon liquidation of a lessee's apartment is of particular significance at this time.

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27. See, Crain's New York Business, January 22, 1990, p. 3, col. 4.

28. See, New York Law Journal, Dec. 12, 1989, p. 1, col. 3.

3.

The essence of the decision below is that the enforceability of contract rights as against a federal tax lien are to be measured by the "choateness" test, without any consideration of whether such rights were treated as "liens" under state law.

In the court's view, financial obligations that had matured under the contract at the time the tax lien was filed would take priority, but subsequent defaults could not be used to diminish the amounts owed to the United States pursuant to the lien.

This doctrine is not limited to cooperative apartments, but may be applied to any species of contract where continuing performance is mandated.[29]

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29 The logic could also be applied to limit the interest of secured creditors otherwise protected under 26 U.S.C. Section 6323.

The application of the doctrine of the Second Circuit would cause confusion in the enforcement of contracts. If the filing of a tax lien gives the government priority as to obligations owing at that time, and prevents the other party from recovering for defaults occurring after the tax lien, in effect the filing of the tax lien would amount to an anticipatory breach of the contract on the part of the party upon whom the lien was filed.

It could hardly be contended that the innocent party should continue to carry out a contract, knowing that it had no contractual right to recover for subsequent defaults by the taxpayer. This court should act to clarify the law and establish uniformity.

CONCLUSION

Review of the instant case by this Court will resolve a conflict between the circuit courts of appeals on an important question of federal law concerning the priorities of parties to the proceeds of a contractual sale, address a matter of considerable importance to all residential housing cooperatives, promote consistency in decisions involving the disposition of property subject to a tax lien, and constitute a proper and necessary exercise of the Court's power of supervision in order to promote compliance with the constitutional principals necessarily involved in this case.

For these reasons Petitioner respectfully requests that this petition for a writ of Certiorari to the United States Court of Appeals for the Second Circuit be granted.

Dated: February 16, 1990

Respectfully submitted,

MARC J. LUXEMBURG
A Member of the Bar of the Supreme Court and Counsel of Record for the Petitioner

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Of Counsel:
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0279k

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1207 August Term 1988

Argued: June 7, 1989

Decided: September 28, 1989

Docket No. 89-6041

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UNITED STATES OF AMERICA,

Plaintiff-Appellee,

-against-

110-118 RIVERSIDE TENANTS CORPORATION,

Defendant-Appellant.

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Before: FEINBERG and KEARSE, Circuit Judges, and BARTELS, District Judge.*

110-118 Riverside Tenants Corporation appeals from a judgment of the United States District Court for the

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* Honorable John R. Bartels, Senior Judge of the United States District Court for the Eastern District of New York, sitting by designation.

Southern District of New York (John M. Cannella, J.) denying its recovery of certain funds held in escrow.

Affirmed, with modification.

MARC J. LUXEMBURG, New York, N.Y. (Ronald J. Katter, Snow Becker Krauss, of Counsel), for Defendant-Appellant.

VICTOR OLDS, Asst. U.S. Atty., New York, N.Y. (Benito Romano, U.S. Atty., Richard W. Mark, Asst. U.S. Atty., New York, N.Y.), for Plaintiff-Appellee.

BARTELS, District Judge:

Defendant-Appellant 110-118 Riverside Tenants Corporation ("Apartment Corporation") appeals from a decision and order of the United States District Court for the Southern District of New York (John M. Cannella, J.)

granting a motion by plaintiff-appellee United States of America ("Government") to compel the law firm of Snow Becker Krauss, P.C. to turn over funds in an escrow account representing the balance of the proceeds of a sale of a cooperative apartment formerly owned by taxpayer John G. Broady.

Background

This case involves the unique property rights of the owner of a cooperative apartment. Ordinarily the purchaser of a cooperative apartment receives a package of rights constituting a proprietary lease (standard as to all tenants) of the premises and a number of shares of the cooperative building corporation which are allocated to the purchaser depending on the size of the apartment. On December 1, 1968 John G. Broady acquired

a cooperative apartment ("Apartment") at 110 Riverside Drive, New York, by purchasing 417 shares of stock in the Apartment Corporation and signing a proprietary lease ("Lease") for the Apartment.[1] Among other things, the proprietary lease involved here provides that shares cannot be transferred, except to the lessor, or after compliance with the provisions of the

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1 The Lease provides:

> In every proprietary lease heretofore executed by the Lessor there has been specified, and in every proprietary lease hereafter executed by it there will be specified, the number of shares of the Lessor appertaining thereto. The number of shares specified in this lease in relation to the aggregate of all numbers of shares similarly specified in all the proprietary leases at the time in force, shall constitute the basis for fixing, as hereinbefore provided, the proportionate share of the aggregate amount of the cash requirements of the Lessor, as hereinbefore defined, which shall be payable as rent by the Lessee.

(A-143).

lease relevant to the assignment of the lease (A-167); that there shall be no assignment of the lease without the transfer of all the shares allocated thereto (A-148-49); that the Board must approve the transfer of the shares and the assignee (A-149); that the lease shall expire on ten days' notice if at any time during the term of the lease the lessee shall cease to be the owner of all the shares (A-159-60); and finally, that unless the owner of the shares pays his monthly proportionate share of the maintenance, after ten days' notice of default the lease shall terminate and the shares shall be surrendered to the Apartment Corporation. (A-160, 163). Thereafter the Apartment Corporation shall sell the shares at a private or public sale, applying the proceeds and expenses of the sale to the indebtedness of the

lessee and paying over any surplus to the lessee. (A-163)

In 1975 the Internal Revenue Service filed notices of tax liens against Broady pursuant to Title 26 United States Code Section 6321 for unpaid taxes for the years 1951-1954. In 1979 the Government commenced an action in the district court against Broady and the Apartment Corporation for Broady's unpaid assessed taxes and moved to foreclose tax liens on Broady's shares of stock. In 1984 the Government was awarded judgment against Broady for $2,396,264.12, and on March 11, 1985 a judgment on the shares of the Corporation was entered.

It was not until after foreclosure of the lien, in April 1985, that Broady defaulted on his maintenance payments due to the Apartment Corporation. As stated above, the shares of the stock of

the Apartment Corporation are allocated to a specific lease without which they cannot be effectively sold. They are not freely negotiable and confer no independent rights separate from the Lease. By the same token, the Lease cannot be assigned without the assignment of the shares.

Efforts were made by the Apartment Corporation to evict Broady, which was accomplished in July 1986, and, in July 1987, the Apartment Corporation entered into a contract for the private sale of the shares of stock. In September 1987 the Apartment Corporation moved for an order approving the private sale of the Apartment "after payment of monthly arrearages owed by defendant Broady to the cooperative corporation and the corporation's costs and disbursements (including legal fees and disbursements) necessarily incurred in connection with

the dispossess proceeding and sale." (A-47) In December 1987, the Government moved to approve the private sale of the Apartment.

On January 27, 1988 the parties entered a stipulation (A-116) regarding the sale of Broady's shares. Four months later, in April 1988, Broady's shares were sold for $901,030. Under the stipulation, the sum of $90,103, to which the Apartment Corporation claimed it was entitled under the terms of the Lease for unpaid maintenance charges, legal fees, and other miscellaneous charges, was placed in escrow by Snow Becker Krauss, P.C., the counsel for the Apartment Corporation, pending the disposition of this case. Thereafter, without authorization from the district court or permission from the Government, Snow Becker Krauss, P.C. paid $9,207 out of the escrow fund to the City of New

York as a Real Property Transfer Tax which Judge Cannella ordered to be returned to the escrow account since he adjudged that all the proceeds belonged to the Government.

The Apartment Corporation contends that it is entitled to the entire escrow fund since under the terms of the Lease Broady was indebted to the Corporation for maintenance charges and was entitled only to the net proceeds of the sale of the Apartment, after payment of his debts to the Corporation. The Government, on the other hand, claims the entire fund on the theory that the tax liens attached to the gross proceeds of the sale prior to the Corporation's claim to Broady's indebtedness. In addition, the Government claims it is not liable for the expense of the sale and that the $9,207 expenditure for the

transfer tax should be returned to the escrow fund.

The District Court held that the federal tax lien had priority over the competing claim of the Apartment Corporation and awarded the entire proceeds of the sale to the Government.

DISCUSSION

I.

Separability of Shares and Lease

Both parties question the effect of the Government's tax lien upon the shares of stock. The Apartment Corporation contends that while the Government attached only the shares and not the Lease, the lien was nevertheless subject to Broady's contractual obligation to pay maintenance under the Lease. The Government, however, contends that the lien attached to the shares separately from Broady's

contractual obligation to pay maintenance.

Before discussing the conflicting claims of the parties, a consideration of the dual nature of a cooperative apartment is appropriate. It was necessary in order to sell this Apartment that both parties come to some sort of an agreement since the sale of the shares alone would be futile and the issuance of a new lease without shares would be equally futile because no purchaser or lessee would acquire the Apartment without both.

Unlike the common understanding of the term "stock," the shares of "stock" in the Apartment Corporation are not freely transferable, and they have no value independent of the Lease for the Apartment. See Grenader v. Spitz, 537 F.2d 612, 617 (2d Cir.), cert. denied, 429 U.S. 1009 (1976), Malkin v. United

States Dep't of Treasury - I.R.S., 645 F. Supp. 229, 231 (S.D.N.Y. 1986). See also In re Matter of Carmer, 71 N.Y.2d 781, 525 N.E.2d 734, 530 N.Y.S.2d 88 (1988), State Tax Comm'n v. Shor, 43 N.Y.2d 151, 371 N.E.2d 523, 400 N.Y.S.2d 805 (1977). As a matter of fact, the stock certificates have printed on their reverse sides the statement that they are subject to the terms of the Lease, which, when added to the terms of the Lease, indicates that the two are inseparable and that a lien on the shares is sufficient to preclude the transfer of the Lease and for all intents and purposes is also a lien on that Lease.

We hold that the shares of stock and the Lease are inseparable and must be treated as a unit. Thus, we are presented with the issues of whether the Government imposed a lien on all of

Broady's property prior to the claim of the Apartment Corporation to the proceeds of the sale and, if the Government has such a prior claim, to what extent the costs and expenses incurred by the Apartment Corporation in effectuating the sale of the shares should be awarded to the Apartment Corporation.

II.

Priority of the Government's Lien

Title 26 United States Code Section 6321 authorizes the imposition by the Government of a tax lien upon the property of the taxpayer when he is in default. See United States v. National Bank of Commerce, 472 U.S. 713, 719-20 (1985).

The priority of a federal tax lien is a matter of federal law. United States v. Acri, 348 U.S. 211, 213 (1954). If we consider the claim of the

Apartment Corporation as a secured interest in the nature of a lien, as it is treated by both the Government and the District Court, then determination of its priority is necessary. In determining whether the tax lien has priority over a competing lien or claim, it is necessary to look at two factors: (1) chronological priority and (2) compliance with the doctrine of choateness. See J.D. Court, Inc. v. United States, 712 F.2d 258, 261 (7th Cir. 1983), cert. denied, 466 U.S. 927 (1984). As stated by the Supreme Court in United States v. Equitable Life Assurance Society:

> As against a recorded federal tax lien, the relative priority of a state lien is determined by the rule "first in time is first in right," which in turn hinges upon whether, on the date the federal lien was recorded, the state lien was "specific and perfected." A

> state lien is specific and perfected when "there is nothing more to be done . . . -- when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." ["]Thus, the priority of [the nonfederal lien] . . . must depend on the time it attached to the property in question and became choate."

384 U.S. 323, 327-28 (1966) (quoting United States v. City of New Britain, 347 U.S. 81 (1954)).

There is no doubt that the Government's lien was filed prior to any claim asserted by the Apartment Corporation and therefore chronological priority was established. For a lien to be "choate" i) the identity of the lienor must be established, ii) the property subject to the lien must be established, and iii) the amount of the lien must be certain. United States v. City of New Britain, 347 U.S. 81, 84

(1954). The fact that the amount is calculable once default occurs is not sufficient to make it choate. United States v. Equitable Life Assurance Society, 384 U.S. at 328-29. The amount of the Apartment Corporation's claim against Broady was not fixed and was inchoate at the time of the imposition of the Government's lien. Consequently, the Government's lien upon the shares of Broady was prior, in all respects, to the claim of the Apartment Corporation. But this conclusion does not end the inquiry.

The Apartment Corporation strongly argues that the issue is not one of priority or choateness but the extent to which Broady had a property interest in his shares at the time the Government imposed its lien. Of course, the imposition of a tax lien must be limited to the actual property interest of the

taxpayer. Aquilino v. United States, 363 U.S. 509 (1960), United States v. Rodgers, 461 U.S. 677, 690-91 (1983). Whether Broady had a property interest when the Government filed its lien is a question of state law. Aquilino v. United States, 363 U.S. at 513. The Lease states, "The Lessor may apply the proceeds received for the issuance of such [new] shares towards the payment of the Lessee's indebtedness hereunder, including interest, attorneys' fees and other expenses incurred by the Lessor and if the proceeds are sufficient to pay the same, the Lessor shall pay over any surplus to the Lessee, but if such proceeds are insufficient the Lessee shall remain liable for the balance of indebtedness." (A-163) For this reason the Apartment Corporation states that the surplus due Broady was all that the Government's lien covered.

In support of this position the Apartment Corporation cites Chicago Mercantile Exchange v. United States, 840 F.2d 1352 (7th Cir. 1988). In that case the Internal Revenue Service imposed a tax lien on the taxpayer's property which included a seat on the Chicago Mercantile Exchange. The Seventh Circuit found that a member of the Exchange had no interest in the proceeds of the sale of the seat until after the Exchange debt was satisfied and, therefore, it concluded the tax lien of the Government could only attach to the net proceeds of the sale since the gross proceeds did not belong to the taxpayer. Id., at 1356. The decision was predicated upon the fact that the rules of the Exchange set forth elaborate transfer procedures and also that a member had no rights in the membership except as granted by these Rules, which

provided that the debt owed to the Exchange had priority. That court relied on two Supreme Court decisions holding that the exchange priority rules were "incidents of the membership interest at its inception," id. at 1358 (citing Chicago Bd. of Trade v. Johnson, 264 U.S. 1 (1924), Hyde v. Woods, 94 U.S. 523 (1876)); accord, Belton v. Hatch, 109 N.Y. 593, 17 N.E. 225 (1888) (New York law); and held that "[t]he rules of the exchange create the property and they govern its attributes." 840 F.2d at 1356. It added that "our holding is very narrow." Id. at 1358. In a footnote the court stated, albeit in a different context, that "a condominium association could draft rules stating that no member could sell his or her unit without paying off debts to other members. This example actually lends credibility to our

decision: such a rule would not have priority over a tax lien on the condominium unit . . . under state law. It is merely a consensual security interest created later, and would therefore not prevail over a filed tax lien." Id. at 1358 n.7.

The nearest approach to an analogous property interest of the shareholder in this case appears in Article III, paragraph FOURTH of the Lease, which provides: "The Lessor may apply the proceeds received for the issuance of such [new] shares towards the payment of the Lessee's indebtedness hereunder... and if the proceeds are sufficient to pay the same, the Lessor shall pay over any surplus to the Lessee . . . ." From this language the Apartment Corporation contends that since Broady was only entitled to the surplus from the sale proceeds after the Apartment Corporation

had been paid its indebtedness, Broady, like a member of the Chicago Exchange, had no property interest in the stock, except in such a surplus, and that this was the only property interest upon which the Internal Revenue Service could impose a tax lien.

But shares of stock in a cooperative corporation are not the same as memberships in an exchange. A seat on an exchange and the interest of a member are encumbered with conditions not applicable to shares in a cooperative. Here the shareholder is entitled to the full value and property interest of the shares subject only to default and can transfer the same subject to the consent requirement of the Lease. We conclude that Chicago Mercantile is not controlling as to cooperative apartments. More important in this case is the fact that at the time the

Government imposed its tax lien there was no default by Broady and no indebtedness due to the Apartment Corporation so it had no right at that time to sell the shares nor any right to the proceeds thereof. At that moment Broady's property interest was to all the proceeds of the shares.

III.

The Corporation's Claim to Maintenance Charges and Expenses

The judgment of foreclosure was obtained by the Government in March of 1985; however the sale of the shares of the stock did not occur until 1988 -- a period of three years later. Broady was evicted in July of 1986. During the ensuing period both the Apartment Corporation and the Government could have taken prompt steps to sell the Apartment and the appurtenant shares and

assign the leasehold thereof. They could have entered into a stipulation sooner than July, 1987, for the sale of the Apartment. It was not until eighteen months after the eviction that the sale of the shares was effectuated. During that time, of course, unpaid maintenance charges accrued. The Apartment Corporation does not point to a particular time or date after Broady's eviction when the Government could have effected a sale. Likewise, the Apartment Corporation does not indicate that it was ready and able to assign the Lease and effectuate a sale on an earlier date but was unable to do so because of the Government's recalcitrance. Thus it is difficult to assess liability against the Government for the maintenance charges during the period the Apartment was vacant, before the actual sale of the shares. It is

true, however, that it was the Apartment Corporation that solicited bids and contracted for and effectuated the sale of the shares of stock, which the district court confirmed. The Government paid none of the expenses incurred in these proceedings.

Accordingly, we find that there are expenses of the foreclosure proceeding which, in all fairness, should be paid by the Government. It was the Government whose duty it was to foreclose the tax lien and collect the taxes from the sale of the shares. This necessitated a number of expenses including attorneys' fees since the Government shifted to the Apartment Corporation the burden of conducting the eviction proceeding as well ae the sale of the stock.

We believe the costs and expenses of eviction and of the sale of the shares

should be paid by the Government and that the same should be deducted from the escrow fund before payment of the remainder to the Government.

Costs of Foreclosure and Sale

There seems to be little doubt that if the sale of the stock had been effectuated by the Government, it would have been liable for the costs of the levy and sale. Title 26 United States Code Section 6342 reads, in relevant part, as follows:

> (a) Collection of liability. -Any money realized by proceedings under this subchapter (whether by seizure, by surrender under section 6322 (except pursuant to subsection (c)(2) thereof), or by sale of seized property) or by sale of property redeemed by the United States (if the interest of the United States in such property was a lien arising under the provisions of this title) shall be applied as follows:
>
> (1) Expense of levy and sale. -First, against the expenses of the proceedings;

See Maryland National Bank v. United States, 227 F. Supp. 504 (D. Md. 1964) (holding that the regulations under 26 U.S.C. §§ 6341-42 imply that when the Government seizes property the Government will pay the expenses of the levy from the proceeds of the sale). See also Smith v. United States, 458 F.2d 1231 (9th Cir. 1972), American Oil Company v. United States, 383 F. Supp. 1281 (N.D. Okla. 1974). Accordingly, there is no reason why the Government should not be liable to the Apartment Corporation for the expenses of these proceedings.

The attorneys' fees incurred by the Corporation for selling the shares for the Government are in the same category as expenses of foreclosure and sale proceedings

which the Government would have been required to incur. Nevertheless, the Government claims that the defendant is barred from receiving attorneys' fees and transfer tax charges until the Government's lien has been satisfied. For this principle it cites a number of cases including United States v. Pioneer American Ins. Co., 374 U.S. 84 (1963). However, the Government has misunderstood the nature of attorneys' fees and expenses in this case. These fees are not attorneys' fees of a third party or of the Apartment Corporation in foreclosing its claim. They are, in reality, attorneys' fees and expenses which would be charged to the Government if it had foreclosed

its own lien and sold the shares of stock.

Creation of Fund - Unjust Enrichment

A person who is unjustly enriched at the expense of another should be required to make restitution to the other. Restatement of Restitution § 1. It is well established that the creator of a fund is entitled to the expenses of creation. "A person who through legal proceedings procures or preserves property in which he and another have an interest may be entitled to reasonable compensation for his services and restitution of his expenses in obtaining or preserving the property." Id. § 105(2).

Here there is no doubt that the Apartment Corporation was the acting party that created the

fund. The Apartment Corporation carried out the Lease's default procedures, brought suit to evict Broady, evicted Broady, obtained appraisals of the Apartment, determined a method of sale, solicited bids, negotiated a contract of sale, sold the Apartment, and made a motion to confirm the sale. Where a party creates a substantial fund at the behest of and for the benefit of another party, equity requires that the expenses of the creator of the fund be paid out of the fund. "The doctrine rests on the perception that persons who obtain the benefit of a lawsuit without contributing to its cost are unjustly enriched at the successful litigant's expense." Boeing Co. v. Van Gemert, 444 U.S. 472, 478 (1980).

See also Trustees v. Greenough, 105 U.S. 527 (1881) (where the Court held that when one of many parties having an interest in a trust fund preserves the fund at his own expense he is entitled to reimbursement from the fund or from the other parties, and this rule applies in creditors' suits and bankruptcy cases as well).

Transfer Tax

The New York Real Property tax in the amount of $9,207 is an expense of the sale. If it is valid and chargeable, it should be charged to the Government as an expense of the sale, and Snow Becker Krauss would therefore be under no obligation to return that sum to the escrow fund.

CONCLUSION

From the foregoing we conclude that the Government's lien extended to all the proceeds of the shares of stock and that as a matter of equity the Government must pay to the Apartment Corporation the expense of preparing the Apartment for sale, evicting Broady, selling the stock including all appurtenant attorneys' fees, as well as expenses incidental thereto. Snow Becker Krauss, P.C. is authorized to transfer to the Government the proceeds it holds in escrow after transferring to the Apartment Corporation the above-described costs, expenses, and attorneys' fees.

The judgment of the District Court is affirmed with the above-noted modifications.

United States Court of Appeals
FOR THE
SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, in the City of New York, on the Twenty-First day of November, one thousand nine hundred and eighty-nine.

UNITED STATES OF AMERICA,

. Plaintiff-Appellee,

- v. -

110-118 RIVERSIDE TENANTS CORPORATION,

Defendant-Appellant.

DOCKET NUMBER 89-6041

A petition for rehearing containing a suggestion that the action

be reheard in banc having been filed herein by Defendant-Appellant 110-118 RIVERSIDE TENANTS CORPORATION.

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

ELAINE B. GOLDSMITH
Clerk

0281k

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------X

UNITED STATES OF AMERICA, :

Plaintiff, :

-against- :

JOHN G. BROADY and 110-118 RIVERSIDE TENANTS CORPORATION, :

Defendants, :

and :

JOSEPH JACOB, :

Intervenor. :

----------X

MEMORANDUM AND ORDER
79 Civ. 3291 (JMC)

CANNELLA, D.J.:

Plaintiff's motion to compel the law firm of Snow Becker Krauss to turn over certain funds is granted.

BACKGROUND

In 1975, the Internal Revenue Service filed notices of tax liens against John G. Broady for unpaid

assessed tax liabilities for the years 1951 through 1954. In 1979, the Government commenced an action against Broady and 110-118 Riverside Tenants Corporation ["RTC"], a cooperative corporation, seeking a judgment against Broady for unpaid assessed taxes and to foreclose tax liens on Broady's shares of stock in RTC, which represented Broady's interest in a cooperative apartment. RTC received notice of the tax liens in 1975.

On March 22, 1984, the Court granted the Government's motion for summary judgment against Broady in the amount of $1,758,721.60. See Memorandum and Order, 79 Civ. 3291 (JMC) (S.D.N.Y. Mar. 22, 1984). Thereafter, the Court granted the Government's request to foreclose the tax liens on Broady's shares of stock in RTC. See Opinion, 79 Civ. 3291 (JMC) (S.D.N.Y. Mar. 3, 1985).

In April 1985, Broady stopped paying his monthly maintenance fee to RTC.

On January 27, 1988 the Government and RTC entered into a stipulation and order regarding the sale of Broady's shares. See Stipulation and Order, 79 Civ. 3291 (JMC) (S.D.N.Y. Jan. 27, 1988) [the "Stipulation"]. In April 1988, Broady's shares were sold for $901,030. Pursuant to the stipulation RTC retained $90,103, which it claimed it was entitled to under the terms of a proprietary lease between RTC and Broady; Broady owed RTC for unpaid maintenance charges, legal fees and other miscellaneous charges accruing between March 1985 and April 1988. The $90,103 was placed in escrow [the "escrow fund"] by Snow Becker Krauss, counsel for RTC, pending the outcome of the instant motion. The remainder of the sale proceeds, $810,927, was paid to

the Government. Finally, Snow Becker Krauss allegedly paid $9,207 out of the escrow fund to the City of New York as a real property transfer tax on the sale of Broady's shares. Payment of the tax was not made pursuant to the stipulation, nor did Snow Becker Krauss receive consent from the Government or permission from the Court before dispensing these funds.

Both the Government and RTC claim the right to the money held in the escrow fund. RTC contends that it is entitled to the escrow fund in order to satisfy Broady's debts to RTC. RTC claims that pursuant to the terms of the proprietary lease between RTC and Broady,[1] Broady was only entitled to the net proceeds of the sale, after his debts to RTC were paid. Thus, RTC argues that the Government's tax liens only reached Broady's interest in the

shares and not the entire proceeds. The Government, on the other hand, asserts that its tax liens attached to the entire proceeds of sale. The Government argues that RTC simply had a lien on Broady's shares which was inferior to the Government's tax liens filed in 1975. Moreover, the Government claims that the $9,207 transfer tax was improperly released from the escrow fund and should be returned to the Government along with the remainder of the fund.

DISCUSSION

Section 6321 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. § 6321, provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or

personal, belonging to such person." The lien arises at the time the taxes are assessed and continues "until the liability for the amount so assessed . . . is satisfied or becomes unenforceable by reason of lapse of time." 26 U.S.C. § 6322; see United States v. National Bank of Commerce, 472 U.S. 713, 719 (1985).

"The statutory language 'all property and rights to property' appearing in § 6321 . . . is broad and reveals on its face that Congress meant to reach every interest in property a taxpayer might have." National Bank of Commerce, 472 U.S. at 719-20; see Glass City Bank v. United States, 326 U.S. 265, 267 (1945)("Stronger language could hardly have been selected to reveal a purpose to assure the collection of taxes.").

A judicial determination of whether a federal tax lien prevails over a competing claim involves a two step inquiry. First, a court must decide what interest the delinquent taxpayer has in the property subject to the lien, as "the Government's lien under § 6321 cannot extend beyond the property interests held by the delinquent taxpayer." United States v. Rodgers, 461 U.S. 677, 690-91 (1983)(footnote omitted); See 21 West Lancaster Corp. v. Main Line Restaurant, Inc., 790 F.2d 354, 356 (3d Cir. 1986)(a federal tax lien can only attach to property "belonging to" the taxpayer). Moreover, in assessing the nature and extent of the taxpayer's property interest, a court must look to state law. See National Bank of Commerce, 472 U.S. at 722 (citing Aquilino v. United States, 363 U.S. 509, 513 (1960)); see also

United States v. Fontana, 528 F. Supp 137, 143 (S.D.N.Y. 1981) ("whether the tax lien has attached depends on the state law question of ownership").

Second, the court must decide if the tax lien that attached to the taxpayer's property has priority over a competing lien or claim. See 21 West, 790 F.2d at 356. In making this determination, which is a matter of federal law, see United States v. Pioneer American Ins. Co., 374 U.S. 84, 88 (1963), "courts have long relied on the judicially created 'choateness doctrine.'" J.D. Court, Inc. v. United States, 712 F.2d 258, 261 (7th Cir. 1983), cert. denied, 466 U.S. 927 (1984). Under the choateness doctrine, a nonfederal lien will have priority over a federal tax lien only if the nonfederal lien was "choate" when the federal tax lien was recorded. See Lerner v. United States,

637 F.2d 679, 681 (S.D.N.Y. 1986). In United States v. Equitable Life Assurance Soc'y, 384 U.S. 323 (1966), the Supreme Court summarized the "choateness doctrine" as follows:

> As against a recorded federal tax lien, the relative priority of a state lien is determined by the rule "first in time is first in right," which in turn hinges upon whether, on the date the federal lien was recorded, the state lien was "specific and perfected." A state lien is specific and perfected when "there is nothing more to be done . . . when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." Thus, the priority of [the nonfederal lien] . . . must depend on the time it attached to the property in question and became choate.

384 U.S. at 327-28 (quoting United States v. City of New Britain, 347 U.S. 81, 84 (1954)).

The Government contends that RTC simply has a "lien" or a "consensual

security interest" in Broady's shares. See Government's Memorandum of Law at 9 and 18, 79 Civ. 3291 (JMC) (S.D.N.Y. Aug. 8, 1988). The Government points out that the Internal Revenue Service filed tax liens against Broady in 1975 and RTC received notice of the liens that same year. Broady did not become indebted to RTC until 1985. The Government asserts that the amount of RTC's security interest was undetermined, and thus "inchoate," when the tax liens were filed. Therefore, the Government argues, the federal tax liens have priority over RTC's security interest.

RTC, however, contends that Broady's property interest in his shares was limited by the terms of the proprietary lease. RTC argues that the instant action is not a dispute between competing lienholders, but rather, that it has a contract right and not a lien.

In sum, RTC's position is that, pursuant to the terms of the proprietary lease, Broady's property interest in the shares was limited to the net proceeds of sale after setting off the amount owed RTC. Thus, the Government's tax lien could only reach Broady's interest and no more.

In support of its position, RTC relies on Chicago Mercantile Exchange v. United States, 840 F.2d 1352 (7th Cir. 1988). In Chicago Mercantile, a taxpayer owned a seat on the Chicago Mercantile Exchange ["CME"]. See id. at 1353. The Internal Revenue Service placed a lien on the taxpayer's seat. In addition to his federal tax liability, the taxpayer also owed a substantial exchange related debt. After conducting an involuntary sale of the taxpayer's seat, CME claimed that it was entitled to satisfy the taxpayer's exchange related debts from the proceeds of sale

before the Government collected on its tax lien. See id. at 1354. CME relied on an internal CME rule which provided that after the sale of a membership, the seat member is only entitled to recover the net amount after payment of exchange related debts. See id.

The Court of Appeals for the Seventh Circuit held that the taxpayer had no property right in the sale proceeds until the exchange related debts were paid. See id. at 1356. The Seventh Circuit stated that the case was essentially controlled by the Supreme Court's decision in Hyde v. Woods, 94 U.S. (4 Otto) 523 (1877), which held that a member's property right in his seat is defined by the rules of the exchange. The Seventh Circuit described the taxpayer's property interest in his seat as follows:

> The rules of the exchange create the property and they govern its attributes. ... [T]he holder of an exchange seat holds that seat subject to the exchange rules, which define and limit his property interest. If he has no property right beyond that granted by the exchange rules, then he has no further property right to which a tax lien can attach.

Chicago Mercantile, 840 F.2d at 1356 (emphasis in original).

Moreover, the Seventh Circuit found that the exchange rules did not give CME an unperfected security interest in the proceeds; instead, the rules were "attributes of the property at its creation." Id. at 1357 (citing Hyde, 94 U.S. at 525-26). The rule in question, the court wrote, "is an incident of the property, not a lien on that property." Chicago Mercantile, 840 F.2d at 1357 (footnote omitted). Thus, the Seventh Circuit concluded that the federal tax lien only attached to the taxpayer's

interest in the property, which consisted of the net proceeds after satisfaction of his exchange related debts. See id. at 1358.

RTC argues that the terms of the proprietary lease, like the rules of the exchange in Chicago Mercantile, do not create a lien on Broady's property, but are incidents of the property itself. RTC's reliance on Chicago Mercantile, however, is misplaced. For several reasons, the principles set forth in that context should not be extended to the facts of the instant action.

The court in Chicago Mercantile emphasized the limited scope of its decision. The court stated that "our holding is very narrow. We only reiterate the Supreme Court's holding that property rights in an exchange membership are determined by thee exchange rules." Chicago Mercantile,

840 F.2d at 1358. Thus, the Seventh Circuit was bound by the Supreme Court's definition of the property interest an exchange member has in his seat.

Broady's property interest in his shares is determined by state law. See National Bank of Commerce, 472 U.S. at 722 (citing Aquilino, 363 U.S. at 513). Under New York law, "[t]he interest in a cooperative apartment is sui generis . . . ; the interest is represented by shares of stock, which are personal property, yet in reality what is owned is not an interest in an ongoing business enterprise, but instead a right to possess real property." In re Estate of Carmer, 71 N.Y.2d 781, 784, 530 N.Y.S.2d 88, 89, 525 N.E.2d 734 (1988)(citing cases). Although RTC argues that the terms of a proprietary lease are, like the exchange rules in Chicago Mercantile, "incidents of

ownership," RTC fails to cite any authority under New York law, and indeed the Court can find none, to support this proposition.[2]

Moreover, policy considerations counsel against such a finding. The collection of taxes is vital to our national government and Congress recognized as much when it passed the federal tax lien laws. See United States v. Kimbell Foods, Inc., 440 U.S. 715, 7]4 (1979) ("The importance of securing adequate revenues to discharge national obligations justifies the extraordinary priority accorded federal tax liens . . ."). Parties should not be allowed to defeat the federal priority scheme "merely by privately contracting to . . . redefine an ordinary security interest as an 'incident of ownership.'" Chicago Mercantile, 840 F.2d at 1359 (Coffey, J.,

concurring). In concurring with the majority decision in Chicago Mercantile, Judge Coffey cautioned that:

> [W]e must be extremely vigilant not to allow either state law or private parties to circumvent . . . important federal policies by attempting to formalistically redefine and codify through rules, regulations, and/or bylaws an ordinary security interest as an incident of property ownership, thereby defeating a valid tax lien that would otherwise take priority.

Id. at 1361.

This reasoning is persuasive in the context of the instant action. The proprietary lease between Broady and RTC was a contract between private parties. Private parties should not be able to evade the federal tax lien statute simply by redefining a security interest as an attribute of property.[3]

Finally, even assuming, arguendo, that under New York law the terms of a proprietary lease are "incidents of

ownership," the proprietary lease in question does not specifically limit Broady's property interest in his shares. The rule at issue in Chicago Mercantile stated: "Membership in the Exchange is a personal privilege subject to purchase, sale, and transfer only as authorized and on the conditions prescribed herein. A member shall have no rights in or to the membership or the proceeds of the sale of such membership except as specifically granted herein." Chicago Mercantile, 840 F.2d at 1356 (emphasis added). The court stated that this rule, in conjunction with the rule allowing exchange related debts to be satisfied from the proceeds of sale of a member's seat, "puts the world on notice" that the member's property interest is limited. Id. A similar term, however, is not found in Broady's proprietary lease. The lease merely

provides that RTC "may apply the proceeds received . . . towards the payment of the Lessee's indebtedness hereunder . . . ." Declaration of Jordan Stanzler, Exh. A, Article III, ¶ ___ 4, 79 Civ. 3291 (JMC) (S.D.N.Y. Aug. 8, 1988). Thus, the lease does not provide, as did the exchange rules in Chicago Mercantile, that the lessee's property interest in his shares is limited by the terms of the lease.

In sum, the Court finds that the terms of the proprietary lease did not serve to limit Broady's property interest in the shares representing his cooperative apartment. Pursuant to the terms of the proprietary lease, RTC merely had a consensual security interest in Broady's shares. See Chicago Mercantile, 840 F.2d at 1358 n.7. Moreover, as the federal tax liens attached in 1975 and Broady did not stop

paying his maintenance fees until 1985, the amount of RTC's security interest was undetermined, and thus "inchoate," when the tax liens attached. See Lerner, 637 F. Supp at 681 ("a 'lien remains inchoate until the underlying debt becomes due.'") (quoting Sgro v. United States, 609 F.2d 1259, 1261 (7th Cir. 1979)). Therefore, the Government's tax liens take priority over RTC's security interest and, as the Government is owed over one million dollars by Broady, the Government is entitled to all the proceeds from the sale of Broady's shares.

One final point deserves mention. Snow Becker Krauss, RTC's counsel, allegedly released $9,207 from the escrow fund to pay a real property transfer tax on the sale of Broady's shares. See Plaintiff's Memorandum of Law at 22, 79 Civ. 3291 (JMC) (S.D.N.Y.

Aug. 8, 1988). The Court has found that the entire proceeds of sale belong to the Government. Thus, the $9,207, which was part of the proceeds of sales also belongs to the Government. Furthermore, Snow Becker Krauss released the money in violation of the stipulation entered into between RTC and the Government, which makes no mention of the tax and provides that "[t]he escrow account shall be disbursed in accordance with the decision of the Court or as [the] parties hereafter stipulate." Stipulation at ¶ 7. RTC's counsel released the funds without consent of the Government or permission of the Court. Accordingly, the Court finds that the $9,207 should not have been used to pay the real property transfer tax and must be returned to the escrow fund.

CONCLUSION

Plaintiff's motion to compel the law firm of Snow Becker Krauss to turn over certain funds is granted. Snow Becker Krauss is hereby directed to transfer the monies held in the escrow fund, plus interest, as well as $9,207, plus interest, to plaintiff, within twenty (20) days of the filing of this Order. Plaintiff is hereby directed to file a proposed Order dismissing this action within ten (10) days of receipt of the money.

SO ORDERED.

JOHN M. CANNELLA
United States District Judge

Dated: New York, New York
February 7, 1989

FOOTNOTES

1. The proprietary lease provides that after termination of the lease because of a default by the lessee, the lessee's shares are deemed void and RTC may sell the shares and issue new shares for the apartment. See Declaration of Jordan Stanzler, Exh. A, Article III, ¶ Fourth, 79 Civ. 3291 (JMC) (S.D.N.Y. Aug. 8, 1988). The lease further provides that:

> The Lessor [RTC] may apply the proceeds received for the issuance of such shares towards the payment of the Lessee's [Broady's) indebtedness hereunder, including interest, attorneys' fees and other expenses incurred by the Lessor and if the proceeds are sufficient to pay the same, the Lessor shall pay over any surplus to the Lessee, but if such proceeds are insufficient the Lessee shall remain liable for the balance of the indebtedness.

Id.

2. RTC cites one New York case in support of the proposition that the terms of the proprietary lease can not create a lien on Broady's shares. See Defendant's Reply Memorandum of Law at 16, 79 Civ. 3291 (JMC) (S.D.N.Y. Jan. 15, 1988). However, a careful reading of the case shows that the court did not base its holding on the terms of a proprietary lease, but on a contract of

sale entered into at a later date. See Banks v. Cox, Treanor & Shaughnessy, 81 A.D.2d 504, 437 N.Y.S.2d 331 (1st Dept. 1981).

Moreover, it is clear that under New York law the terms of a proprietary lease can create a lien in favor of a cooperative corporation. See State Tax Comm'n v. Shor, 43 N.Y.2d 151, 400 N.Y.S.2d 805, 371 N.E.2d 523 (1977) ("The lease provided the lessor with a 'first lien' on [the lessee's] shares of stock for all monetary obligations arising under the lease.").

3. The court in Chicago Mercantile discussed the possibility of this type of "deceptive activity." Chicago Mercantile, 840 F.2d at 1358. In a footnote the court considered the following hypothetical:

> [A] condominium association could draft rules stating that no member could sell his or her unit without paying off debts to other members . . . . [S]uch a rule would not have priority over a tax lien on the condominium unit, since the rule is not an attribute of the unit under state law. It is merely a consensual security interest created later, and would therefore not prevail over a filed tax lien.

Id. at 1358 n.7. (citations omitted) (emphasis in original). Although there

are differences between condominiums and cooperatives, see, e.g., All Seasons Resorts, Inc. v. Abrams, 68 N.Y.2d 81, 90-91, 506 N.Y.S.2d 10, 15, 497 N.E.2d 33 (1986), the above hypothetical is instructive. The Court finds no basis in New York law for concluding that a rule contained in a proprietary lease, which allows the cooperative corporation to collect a shareholder's debt from the sale proceeds of his apartment, is an "attribute" of ownership under state law.

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